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OF THE STATE OF CALIFORNIA

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Investigation on the Commission's Own Motion into Mobile Telephone Service and Wireless Communications

I.93-12-007

Reply Comments of the  
County of Los Angeles

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## I. Introduction

The County of Los Angeles ("County") hereby respectfully submits these reply comments in response to the opening comments submitted by the respondents and other parties in the above-captioned proceeding.

The opening comments submitted in this Investigation represent a broad range of views on a number of contested issues; not surprisingly, however, the respective positions advanced by the respondents and others are keyed to each's own special interests, and consequently largely ignore, or give short shrift to, the important public interest concerns pertinent to the cost and availability of cellular services to individual, business, and particularly to government users of these essential telecommunications resources.

The County is the only government party in this investigation and therefore reiterates here its request for the Los Angeles carriers to make accommodations to the government, in the form of special rates, Priority Access, and E-911, as small compensation for the incredibly valuable licenses that were

granted without charge to those same carriers.<sup>1</sup> These services are essential for public safety and emergency situations.

A recent event in Los Angeles clearly underscores the essential role that cellular plays in supporting key public safety and emergency response requirements, and amply demonstrates the basis for the County's position that government users have unique needs that should be accommodated by the cellular licensees. On March 15, just three days before the filing of these reply comments, Los Angeles County experienced a catastrophic loss of all 911 calling ability as a result of a fire in a key Pacific Bell switching facility in downtown Los Angeles. The central office outage blocked most of the landline and all the cellular 911 calls. Millions of landline calls and paging services were also blocked.<sup>2</sup> This is a clear example of a technological bottleneck that should not have occurred and that certainly can be fixed if adequate redundancy is designed into the public (landline and cellular) telecommunications networks. This man-made disaster could have been prevented with backup equipment and call routing, and of course with fire suppression devices.

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1. All cellular licenses were awarded by the FCC without charge to the original recipient. The fact that certain current holders of these licenses may have paid premium prices for their acquisition does not alter the fact that no compensation was ever paid to any government body in connection with the license grant.

2. See "Fire Disrupts L.A. Phones, Services," Los Angeles Times, March 16, 1994.

Facilities-based cellular carriers can learn from this crisis and take actions that will prevent such disastrous situations from being repeated. For example, after the Northridge earthquake, it was discovered that most cell sites do not have adequate electrical power backup. The County believes that 72-hour battery backup per site should be a minimum requirement. In addition, the MTSOs and all cell sites, including towers and monopoles, should meet the highest earthquake-resistant standards.

As we discuss below, the March 15 event also underscores the fundamentally monopolistic character of the cellular duopoly market structure. The FCC has afforded the two licenses in the Los Angeles area (and in all other CGSAs) more than a decade of protection from competition, a regime under which tens of billions of dollars in profits and market value gains were amassed nationally, excessive prices were imposed, and systems were constructed with little regard for their essential public service role. Notwithstanding the obviously effective industry lobbying efforts at the federal level, cellular is not a service that the California PUC should deregulate any time soon.

## II. Cellular prices are excessive and must be regulated.

While the County's own particular concerns have focused on the special needs of local governments for reliable mobile telecommunications services at reasonable cost, the County believes that the issues it has raised fairly represent the interests and concerns of most users of cellular services. This

belief is corroborated by the substantially similar views expressed by other consumer-oriented comments, particularly those submitted by the Commission's Division of Ratepayer Advocates (DRA).

Indeed, other than the handful of consumer parties, all of the other participants submitting comments seek to use this proceeding to either protect their existing largely monopolistic market position (the facilities-based cellular carriers), to strengthen their existing competitive position (cellular resellers), or to establish a climate conducive to their own entry into the wireless telecommunications business (existing and future providers of non-cellular wireless services). While these efforts are understandable, they are often at odds with the Commission's central mission — to encourage the development of widely available wireless services at affordable, competitive price levels.

The facilities-based cellular carriers, who presently dominate the wireless market and who are able to extract levels of monopoly rents from consumers of their services that are unprecedented in any regulated public utility type of service, are now seeking nothing short of outright deregulation (or its functional equivalent).<sup>3</sup> In support of this agenda, the

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3. See Comments of Los Angeles Cellular Telephone Company ("Comments of LA Cellular"); Opening Comments of Pacific Bell ("Comments of Pacific Bell"); Opening Comments of PacTel Cellular and its Affiliates ("Comments of PacTel"); Initial Comments of GTE Mobilnet of California ("Comments of GTE Mobilnet"); Comments (continued...)

facilities-based cellular carriers have sought to portray their absolutely protected franchises as being some sort of a sieve with competitors biting at their heels from all directions. Applying the broadest possible market definition, the facilities-based cellular carriers ask the Commission to view new companies like Nextel and the future PCS service providers as competitive threats to their present protected duopoly market. Such competition, the facilities-based cellular carriers argue, obviates the need for any type of economic regulation of cellular price levels and marketing practices; indeed, according to the facilities-based cellular carriers, the state commission does not even have the authority to regulate cellular service prices.<sup>4</sup> These carriers hold that the cellular market should be subject to a "relaxed regulatory environment" (a euphemism for deregulation), which they promise will lead to competitive prices for all consumers.

Potential competitors of the incumbent facilities-based cellular carriers, such as Nextel, support continued regulation

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3. (...continued)  
of MaCaw Cellular Communications, Inc ("Comments of MaCaw Cellular"); Opening Comments of US West Cellular of California, Inc. ("Comments of US West"); Opening Comments of Bay Area Cellular Telephone Company ("Comments of Bay Area Cellular"); Opening Comments of Fresno MSA Limited Partnership, Contel Cellular of California, Inc., and California RSA No.4 Limited Partnership ("Comments of Contel"); Comments of the Cellular Carriers Association of California ("Comments of CCAC"); and Comments of GTE California Inc. ("Comments of GTEC").

4. See Comments of LA Cellular at 34-38; Comments of PacTel at 73; Comments of GTE Mobilnet at 27-29; Comments of MaCaw Cellular at 25-27; Comments of US West at 37-39; Comments of Contel at 27; Comments of CCAC at 13-14.

of cellular services, but (not surprisingly) are not asking the Commission to do anything about the egregiously high cellular prices that are currently being charged. These parties agree with the proposed dominant/non-dominant classification for the cellular industry, under which the cellular carriers would remain regulated but the new entrants would not.<sup>5</sup>

The non-facilities-based cellular resellers support the Commission's regulatory framework proposal, which would lead to lower cellular price levels, at least with respect to services furnished by facilities-based carriers to resellers. The resellers argue that the cellular market is not sufficiently competitive to justify price deregulation, and that it continues to function as a true duopoly.<sup>6</sup> The resellers believe that unbundling of the bottleneck elements of wholesale and retail services will create a fairly competitive market, consequently offering lower prices.

While the various providers — facilities-based cellular carriers, cellular resellers, ESMR providers and firms planning to enter the PCS market — all advance positions supportive of their respective business interests and goals, the primary responsibility of this Commission is distinctly not to offer

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5. See Opening Comments of Nextel Communications, Inc ("Comments of Nextel:") and Opening Comments of MCI Telecommunications Corporation ("Comments of MCI").

6. See Opening Comments of Cellular Resellers Association, Inc. ("Comments of CRA") and Opening Comments of Cellular Service, Inc. and Comtech Mobile Telephone Company ("Comments of CSI and Comtech").



comfort to these entities, but rather to protect the interests of the users of the services in question.<sup>7</sup> And what the Commission heard from users is that from their standpoint cellular is distinctly not competitive, prices are excessive and not declining, and continued and effective regulatory protection against the pervasive pattern of overpricing of cellular services remains an essential policy focus. The only parties who expressed the strong need for consumer protection from duopoly behavior and excessive price levels for cellular service were the County of Los Angeles, the Division of Ratepayer Advocates (DRA), Toward Utility Rate Normalization (TURN), and Silicon Valley Council of the Blind.<sup>8</sup> These parties were unanimous in their view that competition is ineffective and that regulatory attention is needed in order to constrain the dominant facilities-based cellular carriers' monopolistic pricing behavior.

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7. Competition is always preferable to regulation, and it is reasonable for the Commission to encourage the development of competition as a device for assuring competitive price levels. However, competition will not happen merely because regulators say that it should, and it certainly will not arrive if existing monopoly providers are permitted to operate without regulatory constraints on their pricing and other business practices. The Commission should view the promotion of competition as a tool for advancing its overall public interest and consumer protection goals and responsibilities, and not as a goal in and of itself.

8. See Comments of the County of Los Angeles ("Comments of LA County"); The Division of Ratepayer Advocates' Comments ("Comments of DRA"); Opening Comments of Toward Utility Rate Normalization ("Comments of TURN"); and Opening Comments of Silicon Valley Council of the Blind.

Rhetoric and anecdotes aside, there is substantial and compelling economic evidence, based upon actual market conditions, that competition for cellular services is basically nonexistent, and that none of the so-called "competitors" that the facilities-based cellular carriers claim to confront are having any consequential impact upon either their price levels or on the prices that would-be purchasers of cellular franchises are willing to pay for the ability to extract monopoly rents from cellular users.

- If ESMR and PCS are such competitive threats to the continued dominance of cellular, why are cellular franchises still trading in the \$200 per "POP" range, some ten times the cost of the cellular system itself?
- If Nextel is a head-on competitor to the existing cellular carriers, why was the price paid by MCI for a 17% share equivalent to about one-fourth to one-fifth (on a per-POP basis) the market value of cellular franchises?
- If the soon-to-be spun-off Pactel Corporation faces such rampant competition as it has sought to portray in its opening comments, why does the stock market continue to value the Company at more than \$200 per POP?
- If Pacific Telesis is so committed to supporting a competitive wireless marketplace, why did it recently oppose FCC actions granting "pioneer preference" licenses to Cox

Enterprises, Omnipoint Communications, Inc. and American Personal Communications, Inc.?<sup>9</sup>

Clearly, it is the present duopoly structure and the failure of regulators to apply basic principles of economic regulation that have created the opportunity for dominant carriers to overprice their services. While the various user parties may differ as to the details of their proposed regulatory solutions, all agree as to the essential need for effective and continued regulation of cellular services in California.

III. The cellular market is not competitive.

None of the industry respondents offered cogent evidence to counter the County's conclusion, as discussed and documented fully in its opening comments, that the cellular market is not competitive and that the new emerging competitors simply do not now, and will not for some time, possess the market power to constrain dominant carrier price levels.

The facilities-based carriers argue extensively that the market is highly competitive and that prices of cellular services have decreased.<sup>10</sup> They claim that Nextel is already a major

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9. See, Letter dated January 26, 1994, by Pacific Bell Counsel, Michael K. Kellogg, ET Docket No. 93-266, Review of the Pioneer's Preference Rules; Gen. Docket No. 90-314, Ammendment of the Commission's Rules to Establish New Personal Communications Services.

10. See, Comments of LA Cellular at 5-11; Comments of Pacific Bell at 14-16; Comments of PacTel at 23-25; Comments of GTE  
(continued...)

competitor and that the new PCS providers will increase competition even further. Yet, LA Cellular admits that this is a very uncertain time and that

"[o]ne can only guess at the impact on cellular competition of digital conversion, the arrival of Nextel, and the introduction of new personal communications services. The effects of the preemptive legislation enacted on August 10, 1993, is also in doubt."<sup>11</sup>

These new services are emerging technologies and therefore do not present price-constraining competition in the near term. As the Cellular Resellers Association noted, "[t]he mere existence of potential providers for 'niche' components of the market does not constitute effective competition."<sup>12</sup>

The County, DRA and TURN appear to agree that the market for cellular services is not competitive and that, as a result, the prices of services have been excessive. The carriers have enjoyed high duopoly rents, which they can maintain due to their market power and current duopoly structure. As DRA noted, "[i]t is inconceivable to assume that firms which are partners in one market and competitors in another actually compete in any meaningful way."<sup>13</sup>

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10. (...continued)  
Mobilnet at 20-23; Comments of MaCaw Cellular at 9-10; Comments of US West at 2; Comments of Bay Area Cellular at 9-11; Comments of Contel at 26; Comments of CCAC at 18-21; and Comments of GTEC at 3.

11. Comments of LA Cellular, at 39 (emphasis supplied).

12. Comments of CRA, at 27.

13. Comments of DRA, at 5.

Facilities-based carriers claim that prices of cellular services have decreased<sup>14</sup> and that competitive pressures resulting from PCS providers and Nextel have already affected the market. However, the market values of cellular companies as well as ESMR providers certainly do not reflect such a condition. Financial markets continue to perceive facilities-based cellular carriers as monopolies, as reflected in the values that the financial markets continue to ascribe to these firms.<sup>15</sup>

Indeed, the very currency with which such properties are valued — dollars per "POP" — is geared to the totality of the potential market rather than to the actual level of business amassed by a particular incumbent. In competitive industries, the market value of individual firms is largely a function of each firm's own business — the size of its customer base, the level of its costs and revenues, potential opportunities for growth and development, and profitability. Only in a fundamentally monopolistic market do would-be buyers look to the aggregate size of the market itself rather than to the fortunes of an individual firm in assessing a firm's intrinsic worth.

The carriers support their claims of competitive pressures solely on the basis of anecdotal evidence of competitive presence, not competitive behavior or impact. Cellular rates remain high; despite nominally lower usage charges, the lower

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14. Op. Cit., footnote 9.

15. Comments of LA County, at 23.

average usage levels when spread over the basic monthly access fees do not create significant downward price trends over time.

Indeed, from the County's own experience in day-to-day dealings with the two facilities-based cellular carriers that serve the Los Angeles area, it is apparent that the two dominant providers behave monopolistically with little or no concern about losing the County's business to the phantom competition which they seek to portray in their opening comments.

The A-block carrier in Los Angeles, the Los Angeles Cellular Telephone Company (LA Cellular), is engaged in seemingly aggressive marketing of its new digital system. As evidenced in an informal survey conducted by the County of ten different resellers and LA Cellular itself, these firms do not mention that LA Cellular's TDMA digital overlay system will be incompatible with Pactel's CDMA digital overlay, expected to be introduced in about a year. An analog/TDMA subscriber unit will not work digitally on an analog/CDMA system. LA Cellular has told the County that it might switch to CDMA sometime in the future, a move that would make the analog/TDMA units nearly worthless. In addition, the LA Cellular digital promotional campaign rarely mentions that the service is available only in the West portion of Los Angeles. LA Cellular never mentions that the customer gets fewer features in the digital mode — for example, data cannot be transmitted when the unit is operating on a digital channel. The 3 watt vehicular/portable interface will not work in the digital mode. It is the County's understanding that, for

technical reasons, a triple mode (analog/TDMA/CDMA) subscriber unit is not in the future. Cellular will never be compatible with ESMR operations. PCS will not be compatible with any other system architecture — and it is not even clear that all PCS systems will be compatible with each other.

Monopolistic behavior is also demonstrated by the unfounded claims of the two Los Angeles area cellular carriers. Pactel is currently running television commercials highlighting "one touch 911 personal safety cellular telephones," showing scenes from the Northridge earthquake in the background. It is unfortunate that not one of the disaster scenes in the commercial is on a freeway, since Pactel's one button 911 service only reaches the California Highway Patrol.<sup>16</sup>

Incredibly, several facilities-based carriers actually seek to blame existing regulation — not their own market power — for the high prevailing price levels. Of course, by "existing regulation" they mean the requirement that carriers file tariffs and disclose prices; there is no present requirement that rates be set at just and reasonable cost-based levels.<sup>17</sup>

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16. Significantly, in the aftermath of the Pacific Bell Bunker Hill central office fire on March 15, 1994, no cellular-originated calls to 911 could be completed County-wide. Clearly, the facilities-based cellular carriers have not felt any competitive pressure to engineer anything close to adequate redundancy in their own systems.

17. See, Comments of PacTel at 6 and Comments of CCAC at 25.

The carriers and the CCAC rely heavily upon Prof. Hausman's study as support for their arguments that the market is highly competitive and that prices have declined as a result of such competition.<sup>18</sup> Prof. Hausman's study also suggests that prices are higher in states subject to regulation. But Hausman fails to acknowledge that higher prices may also be correlated with population density, demand levels and standards of living, and in any event readily admits that no state presently sets cellular rates on the basis of cost.<sup>19</sup> "Regulation" in this regard is limited to the obligation to file tariffs, not to justify prices on traditional public utility grounds. Even LA Cellular observes that "[r]ates tend to be lower in markets with less congestion than Los Angeles."<sup>20</sup>

In fact, there is no reason why the Commission should accept or rely upon the kind of anecdotal evidence offered by the facilities-based carriers. Pacific Telesis has recently proposed the use of so-called "Q-ratios" in assessing the extent of market power in the cable television industry.<sup>21</sup> As Pacific witness Hazlett explains:

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18. See, Comments of CCAC, at 63-64 and Comments of PacTel, at 15.

19. Affidavit of Jerry A. Hausman, United States vs. Western Electric Co., Civil Action No. 82-0192, at 7 and 10, note 15.

20. Comments of LA Cellular, at 14.

21. See Declaration of Thomas W. Hazlett dated February 14, 1994, at 4-5, submitted in Pacific Telesis Group et. al. v. US et. al., No. C93-20915-JW, Memorandum of Law in Support of Plaintiffs' Motion for Summary of Judgment.



8. It is clear that by the late 1980s the cable industry had acquired substantial market power over the local distribution of video programming. The best evidence of this supra-competitive profitability is found in the economic "Q-ratios." In a competitive industry, buyers will be unwilling to pay much more to buy assets than it would cost to build them from scratch. Thus, in a competitive industry, the market value of a business is generally approximated by the replacement cost of its physical assets. The Q-ratio is an economic measure based on this logic. The ratio is defined as:  $Q = \text{Market Value} / \text{Replacement Cost of Capital}$ .

9. In the cable television industry, Q-ratios between about 2.5 and 6 have been estimated in recent years. The typical cable system costs about \$619 per subscriber to build. Yet investors buying cable assets over the past five years have paid about \$2000 per subscriber, or about three times the price that a highly competitive firm would attract in the marketplace. In fact, the average Q-ratio for the firms listed on the New York Stock Exchange in February 1990 was 0.85. A 1990 Brookings Institution study of 20 industries over the 1961-85 time period found an average Q-ratio of 1.28, and just one industry with a Q of more than 2.<sup>22</sup>

In its opening comments, the County cited investment data supplied by Pacific Telesis in I.93-02-028 that suggested an approximate 10-to-1 ratio between the market value of Pactel's California wireline (B-block) licenses and the actual investment in cellular systems made by the Company, implying a Q-ratio of approximately 10. In his testimony for Pacific, Prof. Hazlett interprets the Q-ratio of 3 which he calculated for the cable industry as implying substantial market power and supra-competitive profitability. Clearly, a Q-ratio of 10, more than three times as high as that which Hazlett characterized as implying monopolization, would suggest a virtual monopoly fortress for cellular.

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22. Id., footnotes omitted.

The OII proposes a dominant/non-dominant framework under which existing cellular carriers would generally be treated as dominant.<sup>23</sup> Not surprisingly, the facilities-based carriers have opposed this structure, insisting that they do not qualify as dominant firms in any event.<sup>24</sup> Pacific Bell, CCAC and others seek to compare the cellular market with AT&T's intrastate interLATA market as support for this position.<sup>25</sup> Of course, there is no absolute limit on the capacity of the facilities-based interexchange carriers to provide service, as there is with respect to cellular radio spectrum. There is no specific limit on the number of facilities-based IXCs, whereas with cellular the limit is two per market. Finally, in the case of interexchange services, the essential bottleneck facilities that they utilize are furnished by LECs to any and all IXCs in the market on essentially the same terms and conditions; in the case of cellular, the essential facilities are controlled by the cellular carriers themselves. The Commission can certainly benefit by looking to the regulatory treatment of IXCs for guidance here in order to understand the essential differences between the two cases and the reasons why the dominant classification is entirely appropriate for facilities-based cellular carriers as it is for facilities-based local exchange carriers.

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23. OII at 16.

24. See, Comments of LA Cellular at 33; Comments of Pacific Bell at 24-25; Comments of PacTel at 52-55; Comments of GTE Mobilnet at 26-27; Comments of MaCaw Cellular at 17-18; Comments of US West at 32-34; Comments of Contel at 36; Comments of CCAC at 43; and Comments of GTEC at 2.

25. See, Comments of CCAC, at 41-43; Comments of PacTel, at 23-28; and Comments of US West, at 25-26.

The County believes that the proposed dominant/non-dominant framework for the cellular industry is essential to improve competitiveness of the market generally. This classification will allow the Commission to efficiently regulate the dominant facilities-based cellular carriers while providing opportunities for entry and innovation by others. If in the future the market power of the facilities-based cellular carriers is diminished by competition, the dominant/non-dominant paradigm easily permits reclassification and customization of the regulatory mechanism to satisfy the evolving needs of this market.

IV. Cellular telecommunications is not a discretionary or luxury service, but serves essential public interest needs.

The County strongly disagrees with those parties who persist in their view of cellular services as discretionary.<sup>26</sup> Cellular services are a complement to landline service and are not a substitute.<sup>27</sup> Indeed, Prof. Hausman, who appeared as an expert witness for PacTel in I.93-02-028 (the Pactel "spin-off" investigation) agreed that "... cellular is largely a complement to landline usage, not a substitute."<sup>28</sup>

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26. See, Comments of Pacific Bell, at 23; Comments of PacTel, at 77; Comments of DRA, at 40; Comments of McCaw Cellular, Attachment B at 6; Comments of GTEC, at 7; and Comments of GTE MobilNet of California, at 15.

27. In its 1981 Cellular Order the FCC expressly found that the provision of cellular was in the public interest. See, Cellular Communications Systems, Report and Order, 86 FCC 2d. 469 (1981) (hereinafter "1981 Cellular Order").

28. Testimony of Jerry A. Hausman, I.93-02-028, at 6.

Pacific Bell suggests that the low penetration rates (when compared with landline services) achieved by cellular carriers confirm the fundamentally discretionary character of this service.<sup>29</sup> But the relatively low penetration rate is likely to be far more the result of excessive pricing of cellular services than it is due to any discretionary attributes. The essential role of cellular services thus cannot be defined in terms of the penetration rate or ubiquity of those services, but must be recognized by their use and benefit as a public utility service clearly "affected with the public interest." Furthermore, cellular services penetration rates, which currently stand at about 5%, would likely be considerably higher if prices were lower. As discussed below, the evidence shows that consumers often discontinue the service because of high usage charges.<sup>30</sup>

As the County documented in its opening comments, cellular services have played a crucial role in supporting a broad range of government functions, including many types of emergency response situations. In addition, as the County described, cellular services fill a vital public utility role for

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29. See Opening Comments of Pacific Bell, at 23.

30. For example, US West has noted (Comments of US West, at 13) that the per-subscriber level of cellular usage has declined by 19% between 1989 and 1993, a condition that it expressly attributes to the increased penetration rates that it achieved during this period. Clearly, newer customers are not actually using cellular services to anywhere near the same degree as earlier subscribers. New customers may be lured by "deals" usually involving low-priced (or even "free") cellular telephones, but when they start getting billed for cellular usage they quickly learn to leave their cellular telephone in the trunk.

government, particularly in public safety and emergency response applications. The Commission has itself recognized that "[m]obile service has become an integral part of the telecommunications services relied upon by many businesses and institutions in the state."<sup>31</sup> In his dissent in D.90-06-025, (then) Commissioner Duda acknowledged the important role of cellular services, stating that "[c]ellular telephone service is a natural extension of and enhancement to the wireline telephone network ..." and that "... highly sensitive important government uses of cellular telephone service [...] are in no way discretionary."<sup>32</sup>

In an effort to buttress their otherwise unsupported (and in fact insupportable) claim that cellular is somehow a "substitute" for landline services (a theory which, if true, could support the notion that cellular service is "discretionary"), several facilities-based carriers have averred that cellular and landline usage are "cross-elastic."<sup>33</sup> "Cross-elasticity" is an economic concept that measures a relationship between the price of one product or service and the demand for another product or service. Low cross-elasticity implies low substitutability (demand for meat is probably largely unaffected by the price of textbooks). High negative cross-elasticity implies complementarity between

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31. OII, at 8.

32. Dissent of Commissioner Frederick R. Duda, D.90-06-025, 36 CPUC 2d, 464, at 521.

33. See, Comments of GTE Mobilnet, at 16; Comments of Contel, at 46; and Comments of US West, at 7.

the two products or services (the demand for hot dog rolls increases as the price of hot dogs declines); high positive cross-elasticity implies substitutability between the two products or services (the demand for beef increases with a rise in the price of chicken).

These relationships can be measured and quantified; the Commission has extensive experience dealing with issues of price elasticity,<sup>34</sup> and experts offered or cited by facilities-based carriers in the present Investigation have appeared before this Commission in the past, specifically for the purpose of offering testimony as to the price elasticity of demand for certain telephone services.<sup>35</sup> In the present Investigation, however, the presence of positive cross-elasticity (i.e., substitutability) has been asserted, but no quantitative studies or other evidence supporting this claim has been offered.<sup>36</sup>

In fact, there is substantial evidence to belie the carriers' claim that customers can substitute landline or payphone calls for cellular calls; given the fact that cellular calls are priced from ten to twenty times as much as the

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34. See, e.g., Proposed Decision of ALJ's Amaroli and Lee, Docket No. I.87-11-033, at 254-261.

35. See, e.g., testimony of Jerry A. Hausman (Pacific), Gregory M. Duncan (GTE-California), in I.87-11-033, Implementation and Rate Design Phase, 1991-1992.

36. Such studies would have to be undertaken by the facilities-based cellular carriers because only they possess the requisite price and volume data to permit cross-elasticity to be quantitatively estimated.

alternative landline call, there is no doubt that cellular users defer less important calls to times when they have access to a landline telephone. However, given this extreme price differential, whatever calls could be deferred already are being deferred. If the customer is forced to pay \$1.00 for a call that might cost 5 cents if placed from a landline business telephone (or zero if placed from a flat-rate residential telephone), the fact that the cellular call is nevertheless made implies that for this call the landline alternative is not sufficient. One can hardly claim that landline services "compete" with cellular given these extreme differences in price, and one can hardly claim that customers who are willing (or by circumstances are forced) to accept the high price levels of cellular view these calls as discretionary. None of the important public safety applications cited by the County in its opening comments could be effectively supported by landline-based telephony.

Contrary to the assertions of the facilities-based cellular carriers, there is no basis to conclude that the cross-elasticity of cellular usage and landline usage is other than approximately zero at prevailing price levels for the two types of services. Absent quantitative evidence to the contrary, the Commission should find that cellular and landline usage are not "substitutes" in the economic sense, and on that basis should also find that cellular services are not "discretionary" but are, to their users, essential telecommunications services deserving of full regulatory protection.

V. Prices of bottleneck cellular services should be set on the basis of cost, exclusive of any monopoly rents that may have been paid by the facilities-based carrier in acquiring the franchise on the open market or that are otherwise imputed by the carrier in setting its prices.

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The facilities-based carriers argue that based on existing competition, there is no need for any type of regulation and that, indeed, the Commission is prevented by the FCC to adopt any form of price regulation.<sup>37</sup> The carriers recommend a relaxed regulatory environment which, they claim, will ensure lower prices.<sup>38</sup> The major facilities-based carriers, the Cellular Carriers Association of California (CCAC), and Nextel strongly oppose any requirement for unbundling of the bottleneck elements of cellular services, and argue that unbundling is not called for in a competitive market where (they claim) a cellular bottleneck does not exist.<sup>39</sup>

But cellular services are not competitive, and there are substantial monopoly rents included in cellular prices. The presence of such rents is by itself fully sufficient to belie the carriers' claims as to the presence of price constraining

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37. Op. Cit., footnote 4.

38. See, Comments of LA Cellular at 39-40; Comments of Pacific Bell at ii; Comments of PacTel at 58; Comments of GTE Mobilnet at 26-27; Comments of MaCaw Cellular at 34; Comments of US West at 38-39; Comments of Contel at 30; Comments of CCAC at 74; and Comments of Nextel, at 18-21.

39. See, Comments of LA Cellular at 32-34; Comments of Pacific Bell at 36-40; Comments of PacTel at 66-69; Comments of GTE Mobilnet at 43-46; Comments of MaCaw Cellular at 25-29; Comments of US West at 39-43; Comments of Contel at 21-22; Comments of CCAC at 65-70; and Comments of Nextel, at 18-21.



competition; inclusion of such rents into the prices of essential monopoly services is fundamentally at odds with the most basic principles of public utility regulation.

As the County has noted in its opening comments, the FCC in its cable television regulation rules has expressly prohibited the inclusion of any monopoly rents in CATV rates, and has further prohibited the monopoly rent component of the acquisition cost of an existing cable franchise to be included in rate base for ratemaking purposes.<sup>40</sup> Significantly, the magnitude of such monopoly rents in cable rates — and in the purchase prices of cable franchises — is enormously smaller than in the case of cellular. As Prof. Hazlett demonstrated, the pre-reregulation ratio of system purchase prices to the construction cost of cable systems has been approximately 3-to-1.<sup>41</sup> As the County noted in its opening comments, the market-to-book value ratios for wireline cellular licensees (as evidenced by the gain in market value ascribed to Pactel's B-block California licenses after the spin-off) falls in the 10-to-1 range. Write-ups of rate base to reflect monopoly rents included in acquisition costs is tantamount to condoning, on an ongoing basis, monopolistic public utility prices. Cellular prices should be based upon traditional rate base cost categories exclusive of any premium prices paid by

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40. The FCC has recently indicated a willingness to consider inclusion of some "goodwill" type intangibles as part of the cost basis for cable television rates, where it can be demonstrated that such "goodwill" does not relate to monopoly rents. FCC News Release, February 22, 1994, at 2.

41. See Hazlett, op. cit., footnote 21.